For decades, banks and financial institutions in Malaysia extensively used the traditional Syariah concepts of Bai’ Bithaman Ajil (BBA) and Bai’ al-Inah in Islamic financing. The starting of operations of foreign Islamic banks in Malaysia looks set to change this trend.

Bai’ Bithaman Ajil (BBA) is a contract of sale and purchase of an asset in which the payment of price (which includes profit) is deferred and paid in instalments within an agreed period of time. As practised in Malaysia, there is another contract which precedes this contract, i.e., the sale by the owner of the asset (customer) to the purchaser at a price which is equivalent to the financing amount. This has attracted criticism from many quarters who hold the view that it resembles the Bai’ al-Inah concept which opens the back door to riba (hiyalah ila riba)*.

Bai’ al-Inah is mainly used in Malaysia for a contract of sale and purchase of an asset whereby the seller (the bank) sells to the buyer (customer) the asset at a deferred price and subsequently buys back at a lower price. The majority of Islamic jurists are of the view that the contract of Bai’ al-Inah is not valid as it is considered as a legal device in order to overcome the prohibition of riba, as the motive behind the sale is to get a loan (financing amount) with interest (profit).

However, Syafii jurists (whose view Malaysian scholars follow) are of the view that such sale is valid by the external evidence that it is properly concluded and fulfilled the requirements of a valid sale: the unlawful intention of the parties is immaterial, it does not invalidate their act, unless expressed in that act (nahkum bizzawahir wallahu yatawallassorair).

In order to avoid criticism on Islamic financing in Malaysia and to attract foreign customers, many new Syariah concepts, like the concepts of Musyarakah Mutanaqisah (diminishing Musyarakah) and Tawarruq, have been introduced in Malaysia. This development coincides with the move by Bank Negara (the Central Bank of Malaysia) to grant licenses to 3 foreign Islamic banks, Kuwait Finance House (M) Bhd, Al Rajhi Banking & Investment Corporation (Malaysia) Berhad and Asian Finance Bank Berhad to commence their banking operations in Malaysia.

One of the new Syariah concepts introduced is the concept of Tawarruq. The Syariah Advisory Council of Bank Negara Malaysia in its 51st meeting held on 28th July 2005/21st Jamadil Akhir 1426 resolved that deposit product and financing based on the concept of Tawarruq which is known as commodity Murabahah is permissible.

Tawarruq is defined as an arrangement that involves a purchase of an asset based on Musawamah (price agreed through bargaining) or Murabahah and a subsequent sale of the same asset to a third party in order to gain cash money.

It differs from Bai’ Bithaman Ajil (BBA) as commonly practiced in Malaysia and Bai’ al-Inah as Tawarruq involves a third party, and in Tawarruq transactions there is no condition for the underlying sale object to be returned back (resold) to the original owner (first seller).
A simple mechanism in a Tawarruq financing is illustrated below:

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(i) The bank purchases commodity from trader A in the commodity market on cash basis;
(ii) Thereafter, the bank sells the commodity to the customer on deferred price (cost price plus profit margin);
(iii) The customer may appoint the bank as his agent to sell the commodity to trader B on cash basis in the commodity market; and
(iv) The bank then sells the commodity, as agent of the customer, to trader B on cash basis in the commodity market.
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The emergence of the Syariah concept of Tawarruq marks a new era of Islamic financing in Malaysia. It is also consistent with Malaysia’s aim to promote the Malaysia International Islamic Financial Centre (MIFC) which offers Islamic financial products which are acceptable globally.

*Usury/unfair profit.